

California Cap-and-Trade Program

Guidance on Treatment of Unsold Allowances Following an Undersubscribed Auction

Allowances issued under the California Cap-and-Trade Program and the Québec Cap-and-Trade System are offered for sale in Joint Auctions conducted by California and Québec. These allowances include California state-owned and Québec provincial-owned allowances, California allowances consigned by electrical distribution utilities and natural gas suppliers (consigning entities), and California allowances required to be sold at auction for reasons described in the California Cap-and-Trade Regulation (California Regulation).¹

In the event that an auction is undersubscribed, where not all allowances offered for sale are sold, the California Regulation and the Québec Regulation specify how those unsold allowances are managed and offered at subsequent auctions. This document describes the requirements for the California state-owned and consigned allowances. For purposes of this document, “California allowances” refers to all allowances designated to auction from California sources, including consignment sources and ARB. “California state-owned allowances” refers to ARB allowances held in the Auction Holding Account that are not from consignment sources. “Consigned allowances” refers to allowances consigned to auction from utilities, natural gas suppliers, and other sources as described in the California Regulation.

A. Sources of Allowances to Fulfill Bids

How does ARB award allowances for successful bids in the Current Auction?

If the quantity of bids accepted by the Auction Administrator² equals or exceeds the number of allowances offered for sale in the Current Auction, then all the offered allowances will be sold.

If the quantity of bids accepted by the Auction Administrator is less than the number of allowances offered for sale in the Current Auction, for the allowances offered for sale by California, winning bids will be fulfilled with allowances from sources in the following order (pursuant to section 95911(f) of the Regulation):

- i. Allowances consigned to auction from closed accounts, accounts containing allowances in excess of the holding limit, or accounts suspended or revoked, pursuant to section 95910(d)(2);

¹ California allowances that may be required to be sold at auction can include allowances from closed Compliance Instrument Tracking System Service (CITSS) accounts, allowances from accounts that contain allowances in excess of the holding limit, allowances from suspended or revoked accounts, allowances submitted for untimely surrender obligations, and allowances that were originally freely allocated and have been returned as a result of an enforcement settlement.

² Bids accepted by the Auction Administrator are referred to in the Joint Auction Notices and Joint Auction Summary Results Reports as “qualified” bids.

- ii. Allowances consigned from Limited Use Holding Accounts (LUHAs) pursuant to section 95910(d)(1);
- iii. Allowances designated by ARB that were unsold in prior auctions and are re-designated to the auction pursuant to section 95911(f)(3); and
- iv. Allowances designated by ARB for auction.

Unsold California state-owned and consigned allowances are held in the Auction Holding Account for sale at subsequent auctions. Section B describes the handling of unsold consigned allowances and Section C describes the handling of unsold California state-owned allowances.

B. Consigned Allowances in an Undersubscribed Auction

In each quarterly auction, consigning entities consign allowances that have been allocated to their LUHA to be sold in the Current Auction.

When an auction is undersubscribed, what happens to the consigned allowances that remain unsold?

Pursuant to section 95911(f)(4), allowances consigned to auction from LUHAs and those consigned pursuant to section 95921(g)(3) that remain unsold at auction will be held in the Auction Holding Account and offered in the next auction. If those allowances remain unsold at the next auction, they will continue to remain in the Auction Holding Account and will be offered for sale in each subsequent auction until sold.

If the total number of winning bids is less than the total number of allowances from consignment sources, how will ARB determine the amount to award from each consigning entity?

Winning bids will be filled first with allowances consigned to auction from closed accounts, accounts containing allowances in excess of the holding limit, and accounts that have been suspended or revoked. After all of these allowances from consignment sources are awarded, the remainder of the winning bids will be fulfilled with allowances consigned from LUHAs. The quantity of allowances sold by each consigning entity will be determined as that entity's proportional share of the total allowances consigned from LUHAs.

The number of allowances sold by each entity is calculated as the entity's share of the total consigned allowances multiplied by the total number of consigned allowances sold, rounded down to the nearest whole allowance. If there are remaining consigned allowances to fulfill winning bids, a random number is assigned to each consigning entity and beginning with the lowest random number, an allowance sale is assigned to each entity until all remaining consigned allowances are used to fulfill winning bids.

When will each consigning entity be informed of the total consigned allowances sold by that entity in the auction?

Each entity receives a Consigned Allowances Statement from the Financial Services Administrator no later than the day prior to distribution of auction proceeds.

What happens to unsold allowances consigned from LUHAs at the end of the calendar year?

Any allowances consigned from LUHAs that remain unsold at the end of the calendar year will be offered in the Current Auction of the first auction of the next calendar year. In this case, the Current Auction will include allowances from multiple vintages. Please refer to the [Multiple Vintage Allowances Offered in the Current Auction FAQ](#) available on the ARB Cap-and-Trade Program webpage for more information. If any of those allowances continue to remain unsold, they will remain in the Auction Holding Account and will continue to be offered at each subsequent auction until sold.

When fulfilling winning bids in an auction, do allowances that were consigned from LUHAs in a prior auction and were not sold have priority over newly consigned allowances?

All allowances consigned from LUHAs have the same priority in fulfilling winning bids in an auction, whether they were consigned and unsold in a prior auction or were consigned to that auction.

Must allowances be consigned to the auction if some of the allowances previously consigned remain unsold?

Each calendar year, a consigning entity must offer for sale at auction all allowances that have been placed in its LUHA that correspond to the current calendar year. It is at each consigning entity's discretion to choose when within the calendar year to consign its allowances. The fact that consigned allowances may remain unsold from prior auctions does not alter these requirements. Please refer to the [Guidance for Allowance Consignment to Auction](#) available on the ARB Auction Information webpage for more information.

C. Returning Unsold California State-Owned Allowances to Auction

California state-owned allowances that remain unsold from an undersubscribed Current Auction are returned to auction after two consecutive Current Auctions have resulted in a settlement price above the Auction Reserve Price. Once two consecutive auctions have settled above the Auction Reserve Price, previously unsold California state-owned allowances can be returned to auction. Section 95911(f)(3)(C) of the California Regulation specifies that the maximum number of unsold allowances that can be returned is 25 percent of the California allowances offered at that auction.

How is the 25 percent limit applied?

A numerical example illustrates the application of the 25 percent limit.

The May 2016 Joint Auction offered a total of 67,675,951 current vintage allowances for sale. The undersubscription of the auction resulted in 35,610,823 current vintage California state-owned allowances and 9,031,647 current vintage Québec provincial-owned allowances remaining unsold.³

For purposes of this example, let us assume that the number of allowances designated to the auction following two consecutive auctions that settle above the Auction Reserve Price is the amount shown in Table 1. As shown in the table, 60,000,000 California allowances are offered, which includes both California state-owned and consigned allowances. Applying the 25 percent figure, the maximum number of unsold California-state owned allowances that could be re-designated to this auction would be 15,000,000 (25 percent of 60 million).

The Québec cap-and-trade regulation uses the same 25 percent limit on the return of unsold Québec provincial-owned allowances. Under the Québec regulation, Québec would be able to re-designate 2,500,000 allowances (25 percent of the 10 million allowances indicated in Table 1) that remained unsold from prior auctions.

Assuming the quantity of unsold allowances from prior auctions exceeds the maximum allowable quantity as described above, Table 1 shows the total number of allowances that would be offered for sale at the auction. If the quantity of unsold allowances from prior auctions is less than the maximum allowable quantity, all the unsold allowances would be offered for sale at the auction.

| | California | Québec | Total |
|---|------------|------------|------------|
| Allowances Designated for Auction | 60,000,000 | 10,000,000 | 70,000,000 |
| Previously Unsold State-Owned and Provincial-owned Allowances | 15,000,000 | 2,500,000 | 17,500,000 |
| Total Allowances to be Offered | 75,000,000 | 12,500,000 | 87,500,000 |
| <i>All numbers are illustrative.</i> | | | |

Could ARB decide to re-designate less than 25 percent?

ARB will not re-designate less than 25 percent if the number of unsold allowances equals or exceeds 25 percent. Section 95911(f)(3) states that unsold allowances will be designated to the auction subsequent to two consecutive auctions that have an auction settlement price above the Auction Reserve Price, subject only to the 25 percent limit.

³ A total of 15,773,481 consigned allowances remained unsold at the May 2016 Joint Auction. Section B describes how unsold consigned allowances are managed and offered at subsequent auctions.

What if unsold allowances remain from multiple undersubscribed auctions?

The 25 percent figure applies to all unsold California state-owned allowances, whether they remained unsold at a single auction or multiple auctions. For instance, using the numbers from the example shown in Table 1 above, if California state-owned allowances remained unsold from multiple auctions, the total quantity of unsold California state-owned allowances that could be re-designated to the Current Auction would be at most 15 million.

What do the proposed amendments related to unsold allowances at auction mean?

Currently, unsold California state-owned allowances that remain unsold from an undersubscribed Current Auction will continue to be available and will be returned to auction after two consecutive Current Auctions have resulted in a settlement price above the Auction Reserve Price.

The regulatory proposal released on August 5, 2015, would require for any auction after January 1, 2018, California state-owned current vintage allowances that remain unsold in the Auction Holding Account for more than 24 months to be transferred to the Reserve. This provision is proposed to allow ARB to remove allowances that remain unsold after two years from immediate availability and to supplement the Allowance Price Containment Reserve when the market is depressed for a lengthy period of time.

How are future vintage California state-owned allowances that remain unsold at auction treated?

Future vintage allowances that remain unsold at an Advance Auction are treated in a similar manner to current vintage allowances during the same calendar year in which they were unsold. If two consecutive Advance Auctions settle above the Auction Reserve Price in the same calendar year in which those future vintage allowances were first designated to auction, then unsold future vintage allowances would be re-designated to the Advance Auction up to the 25 percent limit specified in section 95911(f)(3). However, if future vintage allowances remain unsold at the end of the calendar year for which they were designated for sale at Advance Auction, they will remain in the Auction Holding Account until their vintage year. They will then be designated for the Current Auction pursuant to section 95910(c)(1)(B) of the California Regulation.

For example, unsold allowances from an Advance Auction in February could be re-designated to the November Advance Auction (up to the 25 percent figure) if both the May and August Advance Auctions that immediately follow settled above the Auction Reserve Price. However, because there are only four auctions each calendar year, unsold allowances from Advance Auctions in May, August, or November would remain in the Auction Holding Account until their vintage year in all cases.

Where can I find additional information?

For additional information on the Cap-and-Trade Program please visit the Cap-and-Trade website at: <http://www.arb.ca.gov/cc/capandtrade/capandtrade.htm> or contact the Cap-and-Trade Hotline at (916) 322-2037.

For additional information on joint GHG allowance auctions please visit the Auction Information website at: <http://www.arb.ca.gov/auction>